

ALTERNATIVE FORECASTS

Global Insight has assigned a 60% probability of occurrence to its June 2005 baseline forecast of the U.S. economy. The major features of this forecast include:

- Real GDP increases 3.5% in 2005, 3.0% in 2006, 3.1% in 2007, and 3.3% in 2008;
- U.S. nonfarm employment grows 1.7% in 2005, 1.5% in 2006, and 1.0% in both 2007 and 2008;
- the U.S. civilian unemployment rate falls to 5.2% this year and hovers near that level in the remaining years of the forecast;
- consumer inflation is 2.9% in 2005, 2.0% in 2006, 1.8% in 2007, and 2.1% in 2008; and
- the federal unified budget deficit peaks at \$412 billion in 2004 then gradually declines to \$273 billion in 2008.

OPTIMISTIC SCENARIO

The *Optimistic Scenario* has been assigned a 20% probability of occurrence. The *Optimistic Scenario* presented here is simply a further tweaking of the *Optimistic Scenario* that was included in the previous *Forecast*. In the previous version of this scenario there were six assumptions that distinguished the *Optimistic Scenario* from the *Baseline Scenario*. They appear in this scenario as well. First, total factor productivity is stronger. It is the economic equivalent of a miracle pill. It makes economic headaches such as inflation, budget deficits, and sluggish growth disappear. Second, foreign economic growth is stronger, which boosts U.S. exports and strengthens domestic manufacturing. Third, business investment is higher. Fourth, the federal government budget deficit is lower thanks to higher tax revenues and lower federal transfer payments. Fifth, housing starts are stronger in this alternative forecast. Sixth, oil prices are assumed to be about \$5/barrel lower than in the *Baseline Scenario*.

Not surprisingly, these assumptions produce a rosier economic outlook than the baseline case's assumptions. This is verified by reviewing several key indicators. The economy grows 0.2 percentage point faster than in the baseline in 2005 and 1.2 percentage points faster in 2006. Specifically, real GDP advances a healthy 3.7% in 2005, 4.2% in 2006, 3.9% in 2007, and 3.7% in 2008. In the *Baseline Scenario*, real GDP is projected to rise 3.5% this year and about 3% in each of the remaining years of the forecast horizon. Job growth is also stronger. In the *Optimistic Scenario*, nonfarm employment grows 1.8% this year, 2.2% next year, 1.6% in 2007, and 1.2% in 2008. In contrast, in the *Baseline Scenario* nonfarm employment expands 1.7% in 2005, 1.5% in 2006, and 1.0% in both 2007 and 2008. Not only do the number of jobs expand faster, but also the unemployment rate declines more steeply, so that by 2008 it is very close to 4%. Despite the stronger growth, inflation remains in check thanks to the healthy productivity gains. The lower inflation rate allows the Federal Reserve to raise its federal funds slower than in the *Baseline Scenario*, so that it is 50 basis points lower in 2008.

The differences between the Idaho *Optimistic* and *Baseline* forecasts are subtler than at the national level. This is because the improved productivity actually has a dampening affect on the state's economy, particularly its goods-producing sector. For example, the difference in total forecasted Idaho nonfarm employment in 2008 is about 500, which is less than 0.1%. However, the differences between the major employment categories are larger. Specifically, Idaho goods-producing employment is about 900 lower in the *Optimistic Scenario* compared to the *Baseline Scenario*. Part of this gap is made up by nongoods-

IDAHO ECONOMIC FORECAST
BASELINE AND ALTERNATIVE FORECASTS
JULY 2005

	BASELINE				OPTIMISTIC				PESSIMISTIC			
	2005	2006	2007	2008	2005	2006	2007	2008	2005	2006	2007	2008
GDP (BILLIONS)												
Current \$	12,446	13,075	13,741	14,515	12,463	13,208	13,944	14,737	12,435	13,038	13,663	14,543
% Ch	6.1%	5.1%	5.1%	5.6%	6.2%	6.0%	5.6%	5.7%	6.0%	4.9%	4.8%	6.4%
2000 Chain-Weighted	11,226	11,565	11,923	12,319	11,244	11,712	12,170	12,622	11,211	11,441	11,642	11,989
% Ch	3.5%	3.0%	3.1%	3.3%	3.7%	4.2%	3.9%	3.7%	3.4%	2.1%	1.8%	3.0%
PERSONAL INCOME - CURR \$												
Idaho (Millions)	40,322	42,585	44,887	47,565	40,248	42,211	44,350	46,801	40,371	43,026	45,912	49,293
% Ch	6.5%	5.6%	5.4%	6.0%	6.3%	4.9%	5.1%	5.5%	6.6%	6.6%	6.7%	7.4%
U.S. (Billions)	10,319	10,913	11,491	12,170	10,321	10,972	11,612	12,303	10,319	10,916	11,496	12,252
% Ch	6.5%	5.7%	5.3%	5.9%	6.5%	6.3%	5.8%	5.9%	6.5%	5.8%	5.3%	6.6%
PERSONAL INCOME - 2000 \$												
Idaho (Millions)	36,559	37,900	39,206	40,664	36,537	37,785	39,102	40,522	36,506	37,719	39,068	40,566
% Ch	4.1%	3.7%	3.4%	3.7%	4.0%	3.4%	3.5%	3.6%	3.9%	3.3%	3.6%	3.8%
U.S. (Billions)	9,356	9,712	10,036	10,404	9,369	9,822	10,238	10,652	9,331	9,570	9,783	10,083
% Ch	4.1%	3.8%	3.3%	3.7%	4.3%	4.8%	4.2%	4.0%	3.8%	2.6%	2.2%	3.1%
TOTAL NONFARM EMPLOYMENT												
Idaho	602,440	612,863	624,740	637,720	602,402	613,189	624,710	637,207	602,457	611,536	620,928	633,495
% Ch	2.5%	1.7%	1.9%	2.1%	2.5%	1.8%	1.9%	2.0%	2.5%	1.5%	1.5%	2.0%
U.S. (Thousands)	133,701	135,658	136,986	138,364	133,802	136,751	138,936	140,604	133,648	135,056	135,293	136,373
% Ch	1.7%	1.5%	1.0%	1.0%	1.8%	2.2%	1.6%	1.2%	1.7%	1.1%	0.2%	0.8%
GOODS-PRODUCING SECTOR												
Idaho	108,546	106,473	105,630	105,806	108,592	107,200	105,712	104,874	108,747	106,378	103,946	104,655
% Ch	3.0%	-1.9%	-0.8%	0.2%	3.0%	-1.3%	-1.4%	-0.8%	3.1%	-2.2%	-2.3%	0.7%
U.S. (Thousands)	22,135	22,196	22,211	22,225	22,161	22,497	22,844	22,951	22,160	22,149	21,647	21,337
% Ch	1.2%	0.3%	0.1%	0.1%	1.3%	1.5%	1.5%	0.5%	1.3%	0.0%	-2.3%	-1.4%
NONGOODS-PRODUCING SECTOR												
Idaho	493,894	506,390	519,110	531,915	493,810	505,989	518,997	532,332	493,710	505,158	516,981	528,840
% Ch	2.3%	2.5%	2.5%	2.5%	2.3%	2.5%	2.6%	2.6%	2.3%	2.3%	2.3%	2.3%
U.S. (Thousands)	111,565	113,463	114,775	116,139	111,641	114,254	116,093	117,652	111,488	112,907	113,646	115,036
% Ch	1.8%	1.7%	1.2%	1.2%	1.9%	2.3%	1.6%	1.3%	1.7%	1.3%	0.7%	1.2%
SELECTED INTEREST RATES												
Federal Funds	3.2%	4.0%	4.2%	4.5%	3.0%	3.5%	3.7%	4.0%	3.4%	5.3%	6.8%	6.8%
Bank Prime	6.2%	7.0%	7.2%	7.5%	6.0%	6.5%	6.7%	7.0%	6.4%	8.3%	9.8%	9.8%
Existing Home Mortgage	6.0%	6.5%	6.6%	7.0%	5.9%	6.0%	6.1%	6.4%	6.3%	8.3%	8.5%	8.0%
INFLATION												
GDP Price Deflator	2.4%	2.0%	1.9%	2.2%	2.4%	1.7%	1.6%	1.9%	2.4%	2.7%	3.0%	3.4%
Personal Cons Deflator	2.3%	1.9%	1.9%	2.2%	2.4%	1.7%	1.6%	1.9%	2.6%	3.1%	3.0%	3.4%
Consumer Price Index	2.9%	2.0%	1.8%	2.1%	2.7%	1.5%	1.5%	1.7%	3.1%	3.0%	2.8%	3.2%

Forecast Begins the SECOND Quarter of 2005

producing employment, which is about 400 higher than its baseline counterpart. Interestingly, Idaho nominal personal income grows slower in this scenario than in the baseline because of stronger productivity growth. By 2008, personal income is actually \$764 million, or 1.6%, lower than in the baseline. Obviously, some of this difference is the result of the lower inflation in the *Optimistic Scenario*. After adjusting for inflation the gap between the two Idaho personal income forecasts for 2008 shrinks to \$142 million, which is less than 0.4% of the baseline Idaho real personal income estimate.

PESSIMISTIC SCENARIO

The *Pessimistic Scenario* has also been assigned 20% probability of occurrence. A significant feature of the *Pessimistic Scenario* is the re-emergence of inflation. The pickup of inflation reflects higher oil prices, a weaker dollar, two-and-one half years of accommodative monetary policy, and loose fiscal policy. This *Scenario* assumes there is less spare capacity in both the global and U.S. economies than had been previously believed. This is because rapid technological advances and higher oil prices may have rendered current idle capacity obsolete. It is also assumed the U.S. dollar will rapidly weaken as the swelling U.S. trade deficit scares off foreign investors. The flight from greenback-valued investments puts upward pressure on domestic interest rates. In addition, the falling dollar fuels inflation fires. By the start of next year core inflation (overall inflation less food and energy) is over 3%.

The Federal Reserve attempts to stanch inflation raising its federal funds rate faster than in the *Baseline Scenario*. By the end of 2005, its federal funds rate is 4.5%, which is 50 basis points higher than its baseline counterpart. Despite the aggressive tightening, the stock and bond markets both slip on signs the central bank may have let inflation build up too much momentum. The Federal Reserve continues battling inflation by tightening further. By the end of 2007, the federal funds rate is at 7.25% and the U.S. unemployment rate is 6.1%. Between the higher interest rates and persistently high energy prices, consumer confidence wavers, causing consumers to rein in spending. The economy slows as a result. However, it does not sink into a recession. Instead, it fails to grow at its full potential.

Like its national counterpart, Idaho's economy experiences weaker growth in the *Pessimistic Scenario*. This can clearly be seen in the nonfarm employment and personal income projections. Idaho nonfarm employment growth is weaker than in the baseline in every year after 2005. As a result, nonfarm employment is about 4,200 lower (0.7%) in 2008 compared to the baseline estimate. This weakness is more widespread than in the *Optimistic Scenario*, with employment in both the goods- and nongoods-sectors turning in sub-par showings. Idaho nominal personal income is higher than its baseline counterpart in 2008 in this scenario, but the advantage is lost when the projection is adjusted for the higher inflation in the *Pessimistic Scenario*. Specifically, Idaho nominal personal income is \$49.3 billion in this scenario compared to baseline's \$47.6 billion. However, real Idaho personal income is lower than in the baseline, \$40.6 billion versus \$40.7 billion.